

## The "SectorTrends" Newsletter

Generated on 08/08/2006

This weekly newsletter represents technical outlook and short-term picks found for you by OptionSmart. We use our state-of-the-art mathematical models to identify technical signals and select stock/option picks with better chances to win.

We take into consideration both technical analysis and option mathematics so that you can reduce risk and enhance return of your portfolio.

There are two ways to use this newsletter.

First, you can check the corresponding sector trend before entering any stock or option position to avoid fighting it. Second, you can ride sector trends. Sector rotating play becomes very popular nowadays. Sector movements are more predictable, less volatile and have excellent trading vehicles - exchange traded funds and their options.

We consider the following sectors, industries and Exchange Traded Funds:

- **Consumer Discretionary**
- **Consumer Staples**
- **Energy**
- **Financial**
- **Health Care**
- **Industrial**
- **Materials**
- **Technology**
- **Utilities**
- **Telecommunications**
- **Networking**
- **Software**
- **Biotechnology**
- **Semiconductor**
- **Biotech**

Every module of this newsletter covers a swing type implemented with a stock and one of the most effective and popular option strategies:

- BULLISH SWING: **Buy Stock, Buy Call Option and Open Call/Put Spread.**
- BEARISH SWING: **Sell Short Stock, Buy Put Option and Open Call/Put Spread.**

Each rec consists of basic risk/reward parameters. We even calculate these parameters per \$1 invested to allow you an easy comparison of various picks. We also recommend that you pay attention to the daily and weekly technical signals for each sector.

Please feel free to email to mail to: [swings@optionsmart.com](mailto:swings@optionsmart.com) if you have questions about this newsletter and option trading in general.

DISCLAIMER: Information for the stock observations was obtained from sources believed to be reliable, but we do not warrant its completeness or accuracy, or warrant any results from the use of the information. Your use of the stock observations is entirely at your own risk and it is your sole responsibility to evaluate the accuracy, completeness and usefulness of the information. You must assess the risk of any trade with your broker and make your own independent decisions regarding any securities mentioned herein.

Copyright © 2006 Stock Markets Institute. All rights reserved.

## Industry & Sector Ratings

Sector	ST Rating	LT Rating	ST Outlook	LT Outlook	ST Strength	LT Strength
<b>Consumer Discretionary</b>	<b>Hold</b>	<b>Hold</b>	<b>Bullish</b>	<b>Bearish</b>	<b>Up</b>	<b>Down</b>
<b>Consumer Staples</b>	<b>Hold</b>	<b>Hold</b>	<b>Bullish</b>	<b>Bullish</b>	<b>Down</b>	<b>Up</b>
<b>Energy</b>	<b>Hold</b>	<b>Hold</b>	<b>Bullish</b>	<b>Bullish</b>	<b>Down</b>	<b>Up</b>
<b>Financial</b>	<b>Hold</b>	<b>Hold</b>	<b>Bullish</b>	<b>Bearish</b>	<b>Up</b>	<b>Up</b>
<b>Health Care</b>	<b>Hold</b>	<b>Hold</b>	<b>Bullish</b>	<b>Bullish</b>	<b>Down</b>	<b>Up</b>
<b>Industrial</b>	<b>Buy</b>	<b>Buy</b>	<b>Bullish</b>	<b>Bearish</b>	<b>Down</b>	<b>Down</b>
<b>Materials</b>	<b>Buy</b>	<b>Buy</b>	<b>Bullish</b>	<b>Bearish</b>	<b>Up</b>	<b>Down</b>
<b>Technology</b>	<b>Hold</b>	<b>Hold</b>	<b>Bullish</b>	<b>Bearish</b>	<b>Up</b>	<b>Down</b>
<b>Utilities</b>	<b>Hold</b>	<b>Hold</b>	<b>Bearish</b>	<b>Bullish</b>	<b>Down</b>	<b>Up</b>
<b>Telecommunications</b>	<b>Hold</b>	<b>Hold</b>	<b>Bullish</b>	<b>Bullish</b>	<b>Up</b>	<b>Up</b>
<b>Networking</b>	<b>Hold</b>	<b>Hold</b>	<b>Bullish</b>	<b>Bearish</b>	<b>Up</b>	<b>Down</b>
<b>Software</b>	<b>Hold</b>	<b>Hold</b>	<b>Bullish</b>	<b>Bearish</b>	<b>Up</b>	<b>Neutral</b>
<b>Biotechnology</b>	<b>Hold</b>	<b>Hold</b>	<b>Bullish</b>	<b>Bearish</b>	<b>Up</b>	<b>Down</b>
<b>Semiconductor</b>	<b>Hold</b>	<b>Hold</b>	<b>Bullish</b>	<b>Bearish</b>	<b>Up</b>	<b>Down</b>
<b>Biotech HOLDERS</b>	<b>Hold</b>	<b>Hold</b>	<b>Bullish</b>	<b>Bearish</b>	<b>Down</b>	<b>Up</b>

## Buy Stocks (Exchange Traded Funds):

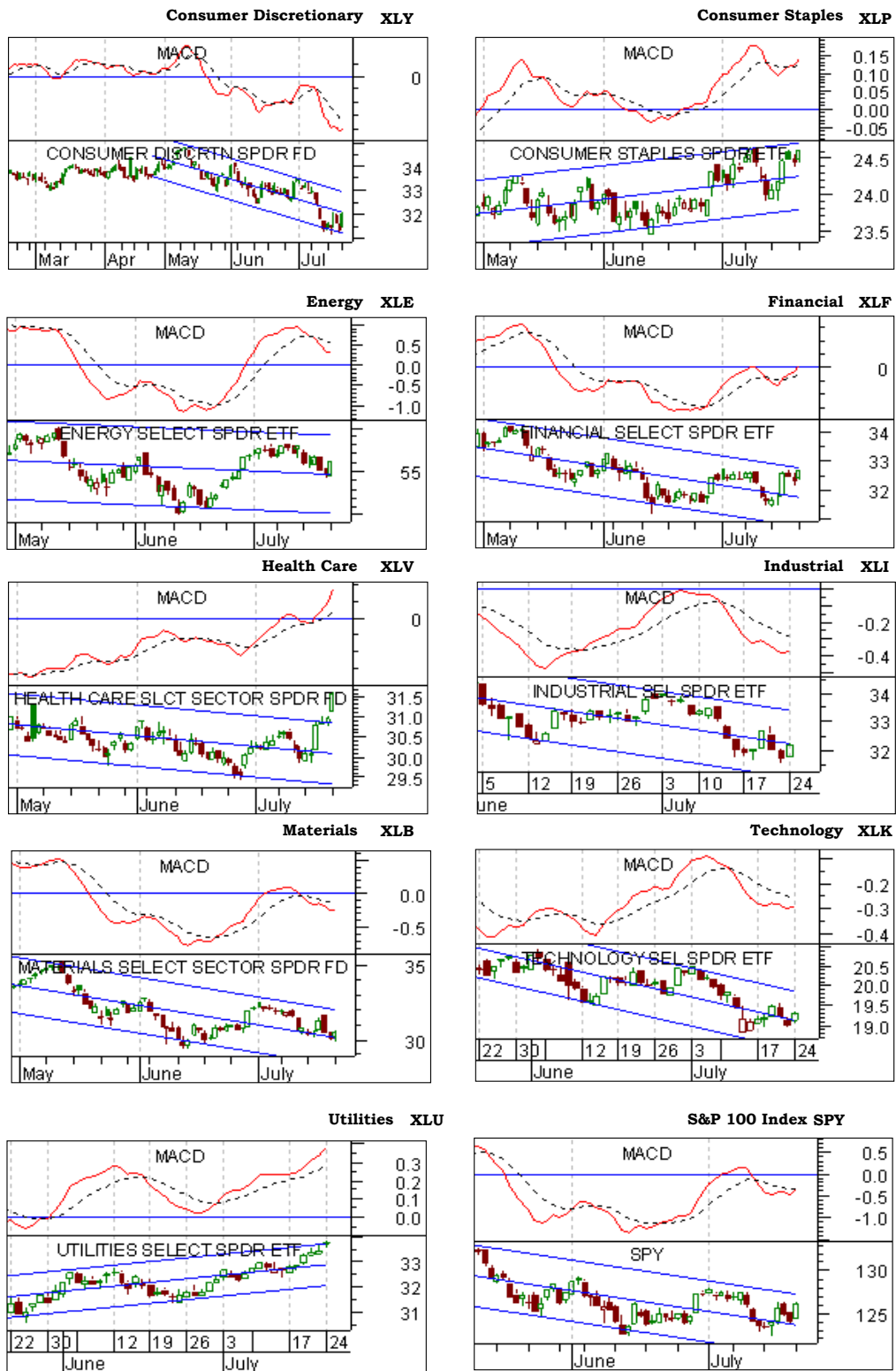
Sector	Symbol	Last	Target	Stop
<b>Materials</b>	<b>XLB</b>	<b>31.33</b>	<b>32.55</b>	<b>29.62</b>
<b>Industrial</b>	<b>XLI</b>	<b>31.93</b>	<b>32.89</b>	<b>31.42</b>

## Sell Short Stocks (Exchange Traded Funds):

This module is empty because the picks found had very low probability to be profitable.

Sector	Symbol	Last	Target	Stop

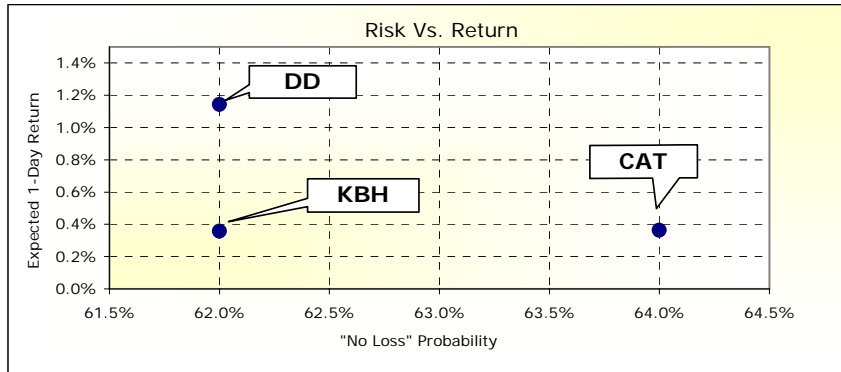
**Long-Term Trends for Featured Sectors**



**BULLISH PLAY: Buy Call Strategy**

Symbol	Last	Buy to Open				Last	Target	Stop	1)	2)	Time Value	Sector	Symbol
DD	39.63	Jan-07	35.0	Call at	2.50	5.70	3.50	1.00	62%	1.14%	1.07	Materials	DDAG
CAT	73.18	Jan-07	65.0	Call at	7.10	11.76	8.00	3.50	64%	0.36%	3.58	Industrial	CATAM
KBH	31.30	Jan-07	35.0	Call at	8.00	13.40	9.00	3.00	62%	0.36%	13.40	Industrial	KBHAG

1) "No Loss" Probability. 2) Expected 1-Day Return.



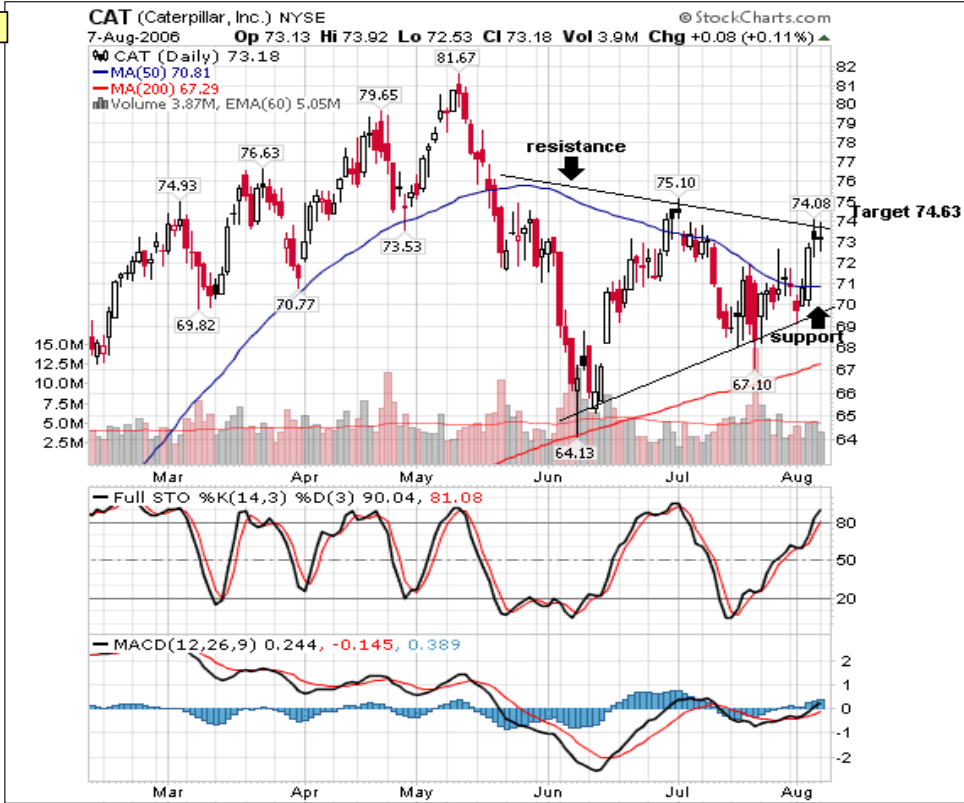
**DD**



Chart courtesy of StockCharts.com

**BULLISH PLAY: Buy Call Strategy**

**CAT**



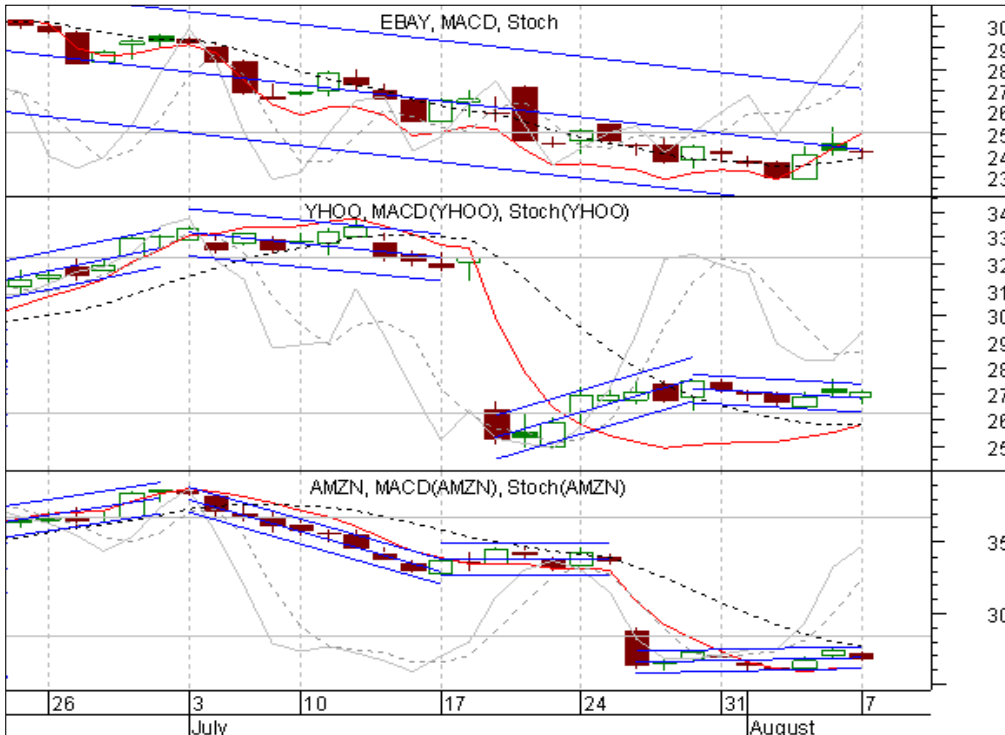
**KBH**



Chart courtesy of StockCharts.com

**TOP THREE STOCKS THAT ARE MOVING THE INTERNET SECTOR NOW**

Product Name	Symbol	% of Market Value	Short-Term Tech Signals		Sector	Short-Term Industry Trend	Short-Term Sentiment
			MACD	Stochastic Oscillator			
Ebay Inc	EBAY	32.4%	Bullish	Bullish	Consumer, Noncyclical	Bearish	Bearish
Yahoo! Inc.	YHOO	28.4%	Neutral	Bullish	Technology	Bearish	Bullish
Amazon.com, Inc.	AMZN	13.4%	Bearish	Bullish	Consumer, Cyclical	Bullish	Bearish
Overall Sentiment:							<b>Bearish</b>

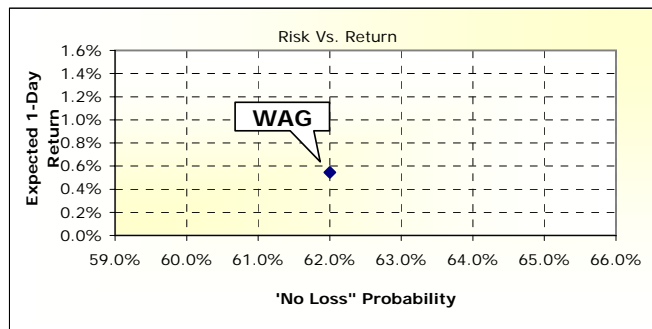


**BEARISH PLAY: Buy Put Strategy**

This module is empty because the picks found had very low probability to be profitable.

Symbol	Last	Buy to Open	Last	Target	Stop	1)	2)	Time Value	Sector	Symbol
WAG	48.41	Oct-06 55.0 Put at 4.20	0.00	5.00	2.00	62%	0.54%	0.00	Consumer Discretionary	WAGVK

1) "No Loss" Probability. 2) Expected 1-Day Return.



### BULLISH CALL SPREAD STRATEGY

Symbol	Expirat Month	Buy Strike	Sell Strike	Debit	Max Profit	Break-Even	Max Loss	Profit/Loss	Sector	Buy Side Symbol	Sell Side Symbol
<b>DD</b>	Jan-07	35.0	40.0	3.60	1.40	38.60	3.60	0.39	<b>Materials</b>	DDAG	DDAH
<b>CAT</b>	Jan-07	65.0	70.0	3.46	1.54	68.46	3.46	0.45	<b>Industrial</b>	CATAM	CATAN
<b>KBH</b>	Jan-07	35.0	40.0	3.50	1.50	38.50	3.50	0.43	<b>Industrial</b>	KBHAG	KBHAH

### BULLISH PUT SPREAD STRATEGY

Symbol	Expirat Month	Buy Strike	Sell Strike	Credit	Max Profit	Break-Even	Max Loss	Profit/Loss	Sector	Buy Side Symbol	Sell Side Symbol
<b>DD</b>	Jan-07	35.0	37.5	0.60	0.60	36.90	1.90	0.32	<b>Materials</b>	DDMG	DDMU
<b>CAT</b>	Nov-06	65.0	70.0	1.70	1.70	68.30	3.30	0.52	<b>Industrial</b>	CATWM	CATWN
<b>KBH</b>	Jan-07	35.0	40.0	1.50	1.50	38.50	3.50	0.43	<b>Industrial</b>	KBHMG	KBHMH

**DD**



**CAT**



Chart courtesy of StockCharts.com

**BULLISH PUT SPREAD STRATEGY**

**KBH**



Chart courtesy of StockCharts.com

**BEARISH CALL SPREAD STRATEGY**

This module is empty because the picks found had very low probability to be profitable.

Symbol	Expirat Month	Buy Strike	Sell Strike	Credit	Max Profit	Break-Even	Max Loss	Profit/Loss	Sector	Buy Side Symbol	Sell Side Symbol
<b>WAG</b>	Oct-06	55.00	52.50	0.60	0.60	53.10	1.90	0.32	<b>Consumer Discretionary</b>	WAGJK	WAGJX

**BEARISH PUT SPREAD STRATEGY**

This module is empty because the picks found had very low probability to be profitable.

Symbol	Expirat Month	Buy Strike	Sell Strike	Debit	Max Profit	Break-Even	Max Loss	Profit/Loss	Sector	Buy Side Symbol	Sell Side Symbol

### Pros and Cons for Our Bullish Picks

Symbol	Bullish Factors	Bearish Factors
<b>DD</b>	<ul style="list-style-type: none"> <li>• support at 39,</li> <li>• forming bottom,</li> <li>• stoch (weekly) - oversold,</li> <li>• high dividend yield,</li> <li>• Trailing P/E (20) &gt;&gt; Forward (13),</li> <li>• high ROE,</li> </ul> forming triangle, supportive fundamentals	<ul style="list-style-type: none"> <li>• nearest resistance at 42-43,</li> <li>• bearish trend since May-06,</li> <li>• EPS revisions trend - down</li> </ul>
<b>CAT</b>	<ul style="list-style-type: none"> <li>• break-out resistance lines,</li> <li>• forming bottom,</li> <li>• support at 200-MA,</li> <li>• MACD (daily) - bullish,</li> <li>• low P/E, PEG, P/S,</li> <li>• high ROE,</li> <li>• EPS revisions trend - up</li> </ul> strong fundamentals, supportive industry trend	<ul style="list-style-type: none"> <li>• nearest resistance at 76-77,</li> <li>• MACD (weekly) - bearish,</li> <li>• high P/B,</li> </ul>
<b>KBH</b>	<ul style="list-style-type: none"> <li>• support at 38-42,</li> <li>• MACD (daily) - bullish,</li> <li>• RSI (weekly) - oversold,</li> <li>• low PEG, P/E, P/S, P/B,</li> <li>• high profit &amp; operating margins,</li> </ul> forming bottom, supportive industry trend	<ul style="list-style-type: none"> <li>• nearest resistance at 51,</li> <li>• bearish trend since Jan-06,</li> <li>• MACD (weekly) - bearish,</li> <li>• EPS revisions trend - down,</li> <li>• near-term overbought</li> </ul>

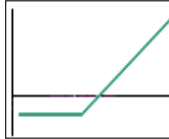
### Pros and Cons for Our Bearish Picks

Symbol	Bullish Factors	Bearish Factors
<b>WAG</b>	<ul style="list-style-type: none"> <li>• support at 46-47,</li> <li>• MACD (weekly, daily) - bullish,</li> <li>• supportive industry trend</li> </ul>	<ul style="list-style-type: none"> <li>• resistance at 50,</li> <li>• stoch (weekly, daily) &amp; RSI (weekly, daily) - overbought,</li> <li>• high P/E, PEG, P/B,</li> <li>• EPS revisions trend - neutral</li> </ul> near-term overbought

## SHORT GLOSSARY

Buy -	JCPBE	Feb	25	Call	@ 1.05
<b>Position</b>	<b>Symbol</b>	<b>Expiration Month</b>	<b>Strike</b>	<b>Option Type</b>	<b>Recommened Entry Price</b>

**Break-even.** Point at which gains equal losses. This is the market price that a stock must reach for an option to avoid loss if exercised. For a call, the break-even equals the strike plus the premium paid.

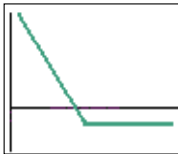
**BUY CALL**

**WHEN TO USE:** You are very bullish on the stock. The more bullish you are, the higher the strike should be. No other position gives you so much leveraged advantage with limited downside risk.

**PROFIT:** increases as stock rises. At expiration, break-even point will be option strike A plus premium paid. For each point above break-even, profit increases by an additional point. **LOSS:** is limited to the premium paid. Maximum loss realized if the stock ends below A. For each point above A, loss decreases by additional point.

**RISK:** Limited. **REWARD:** Unlimited. **MARGIN:** Not required.

**TIME DECAY:** This position is a wasting asset. As time passes, value of position erodes toward expiration value. If volatility increases, erosion slows; if volatility decreases, erosion speeds up.

**BUY PUT**

**WHEN TO USE:** You are very bearish on stock. The more bearish you are, the more out-of-the-money (lower strike) should be the option you buy. No other position gives you as much leveraged advantage in a falling stock (with limited upside risk).

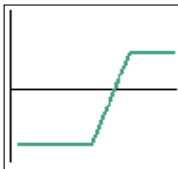
**PROFIT:** increases as stock falls. At expiration, break-even point will be option exercise price A less premium paid. For each point below break-even, profit increases by additional point.

**LOSS:** limited to amount paid for option. Maximum loss is realized if the stock ends above option exercise A. For each point below A, loss decreases by additional point.

**RISK:** Limited. **REWARD:** Unlimited.

**TIME DECAY:** This position is a wasting asset. As time passes, value of position erodes toward expiration value. If volatility increases, erosion slows; if volatility decreases, erosion speeds up.

**BULL SPREAD** Call option is bought with a strike price of A and another call option sold with a strike of B, producing a net debit. **OR** Put option is bought with a strike of A and another put sold with a strike of B, producing a net credit.



**WHEN TO USE:** you think the stock will go up somewhat or at least is a bit more likely to rise than to fall. Good position if you want to be in the stock but are unsure of bullish expectations. This is the most popular bullish strategy.

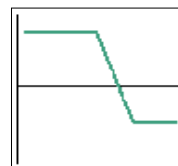
**PROFIT:** limited, reaching maximum if stock ends at or above the higher strike B at expiration. If call spread used, difference between strikes minus initial debit. If put spread used, net initial credit.

**LOSS:** maximum loss if stock at expiration is at or below A. If call spread used, maximum loss is net initial debit. If put spread, difference between strikes minus initial credit.

**RISK:** limited. **REWARD:** limited.

**TIME DECAY:** if stock is midway between A and B, no time effect. At B, profits increase at fastest rate with time. At A, losses increase at maximum rate with time.

**BEAR SPREAD** Put option is bought with a strike price of A and another put option sold with a strike of B, producing a net debit. **OR** Call option is bought with a strike of A and another call sold with a strike of B, producing a net credit.



**WHEN TO USE:** you think the stock will go down somewhat or at least is a bit more likely to fall than to rise. Good position if you want to be in the stock but are unsure of bearish expectations. This is the most popular bearish strategy.

**PROFIT:** limited, reaching maximum if stock ends at or below the lower strike B at expiration. If put spread used, difference between strikes minus initial debit. If call spread used, net initial credit.

**LOSS:** maximum, if stock at expiration is at or above A. If put spread used, maximum loss is net initial debit. If call spread, difference between strikes minus initial credit.

**RISK:** limited. **REWARD:** limited.

**TIME DECAY:** if the stock is midway between A and B, no time effect. At A, profits increase at fastest rate with time. At B, losses increase at maximum rate with time.

**Call Option.** The right, but not the obligation, to buy the stock at a predetermined price (also known as the strike) at any moment before the expiration date for a paying a premium.

**"No losses" Probability.** Once you set a certain minimum level for this parameter, you can reject the picks that go beyond your desired risk level.

**Expected Profit** is computed using the probability of profit and option prices over the projected probabilities. It is equal to the probability of profit multiplied by the price and sum over all possibilities.

**Example.**

Outcome 1. Probability = 0.1, Profit= \$6

Outcome 2. Probability = 0.3, Profit= \$4

Outcome 3. Probability = 0.2, Profit= \$1

Outcome 4. Probability = 0.2, Profit= -\$1

Outcome 5. Probability = 0.1, Profit= -\$2

Outcome 6. Probability = 0.1, Profit= -\$3

Expected wins = \$2.00 =  $0.1 * \$6 + 0.3 * \$4 + 0.2 * \$1$ , Expected losses =  $\$0.70 = 0.2 * \$1 + 0.1 * \$2 + 0.1 * \$3$ .

Expected profit equals the wins minus the losses, or \$1.30. Next, to compute the odds of the trade, the expected wins are divided by the expected losses. In this case, the odds of success equal 2/0.70 or 2.9 to 1.

As a rule, when searching for picks, two of the three variables - odds of success, No losses probability, and expected profit should benefit the trade. Generally speaking, traders struggle for odds higher than 1:1. A ratio of 3:1 tells the trader that he or she is risking \$1.00 for the potential of making \$3.00. In the same way, most traders make every effort to find picks that have positive expected profits.

**Expiration Date.** The day when an option contract becomes void (the Saturday after the third Friday of the expiration month).

**In-the-Money Option.** An option that has intrinsic value. A call (put) option is in-the-money if the strike is less (greater) than the current market price of the stock.

**Intrinsic Value:** The value of an option if it were to expire immediately with the underlying stock at its current price or the amount by which an option is in-the-money. For call options, this is the difference between the stock price and the striking price, if that difference is a positive number, or zero otherwise. For put options it is the difference between the striking price and the stock price, if that difference is positive, and zero otherwise.

**"No losses" Probability.** Once you set a certain minimum level for this parameter, you can reject the picks that go beyond your desired risk level.

**Sector Trends and Strength.** We distinguish short-term and intermediate-term time horizons, based on various technical indicators for daily and weekly charts.

**Stock Technical Signals** are based on various technical indicators for daily and weekly charts. Usually, swing traders check weekly charts to avoid fighting longer-term trends, while investors check daily charts for better timing of entry/exit points.

**Stock Strength** is also very important in decision-making. Any given stock fluctuates against its sector. For example, imagine that you bet on an upward move of a stock in a rising sector. Are you sure this stock is really strengthening in this sector at the moment? A common approach here is to base a pick on the size of the company or the strength of its brand, which can lead to a major mistake. Almost any stock can outperform its sector for a while. However, if it temporarily underperforms, you will lose.

Clearly, you should bet on a leader. But how can you recognize who will be the leader between your entry and exit points? We can help you. Our charts represent both short-term swings and intermediate-term fluctuations and assist you in selecting the best entry and exit points.

**Put Option** - the right, but not the obligation, to sell stock at a predetermined price (also known as a strike) at any moment before the expiration date.

**Spread.** A position with long and short options of the same type on the same underlying stock or index.

**Striking Price.** The price at which the option holder may buy or sell the underlying security, as defined in the terms of his option contract.

**Time Value.** Amount by which the current market price of an option exceeds its intrinsic value (the difference between the stock price and the strike). This additional value of an option is due to the volatility of the market and the time remaining until expiration.

Copyright © 2006 OptionSmart.com and Stock Markets Institute. All rights reserved.

DISCLAIMER: Information for the stock observations was obtained from sources believed to be reliable, but we do not warrant its completeness or accuracy, or warrant any results from the use of the information. Your use of the stock observations is entirely at your own risk and it is your sole responsibility to evaluate the accuracy, completeness and usefulness of the information. You must assess the risk of any trade with your broker and make your own independent decisions regarding any securities mentioned herein.